

UNITED STATES DISTRICT COURT
DISTRICT OF MAINE

PEOPLES HERITAGE SAVINGS BANK,)	
)	
Plaintiff)	
)	
v.)	Civil No. 90-0277 P
)	
KMS MANAGEMENT CORP.,)	
)	
Defendant)	

**RECOMMENDED DECISION ON PLAINTIFF'S
MOTION FOR SUMMARY JUDGMENT**

Peoples Heritage Savings Bank ("Peoples") moves for summary judgment in this diversity case seeking money owed on a defaulted promissory note. Defendant KMS Management Corp. ("KMS") concedes liability but contends genuine issues of material fact preclude summary judgment as to the amount owed. For the reasons articulated below, I recommend that this court grant summary judgment as to liability but deny it as to damages.

I. SUMMARY JUDGMENT STANDARDS

Fed. R. Civ. P. 56(a) provides that "[a] party seeking to recover upon a claim . . . may . . . move with or without supporting affidavits for a summary judgment in the party's favor upon all or any part thereof." Such motions must be granted if

the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.

Fed. R. Civ. P. 56(c). The party moving for summary judgment must demonstrate an absence of evidence to support the nonmoving party's case. *Celotex Corp. v. Catrett*, 477 U.S. 317, 325 (1986). In determining if this burden is met, the court must view the record in the light most favorable to the nonmoving party and "give that party the benefit of all reasonable inferences to be drawn in its favor." *Ortega-Rosario v. Alvarado-Ortiz*, 917 F.2d 71, 73 (1st Cir. 1990) (citation omitted). "Once the movant has presented probative evidence establishing its entitlement to judgment, the party opposing the motion must set forth specific facts demonstrating that there is a material and genuine issue for trial." *Id.* at 73 (citations omitted); Fed. R. Civ. P. 56(e); Local R. 19(b)(2). A fact is "material" if it may affect the outcome of the case; a dispute is "genuine" only if trial is necessary to resolve evidentiary disagreement. *Ortega-Rosario*, 917 F.2d at 73.

II. FACTUAL CONTEXT

The parties' submissions¹ reveal the following undisputed facts. Peoples negotiated the note underlying the instant suit in December 1986 to secure the repayment of \$775,000 loaned to Kelsar Corporation ("Kelsar") to purchase residential property on outer Congress Street in Portland, Maine and prepare it for construction. Exh. 1 to Plaintiff's Statement of Undisputed Facts ("Plaintiff's Statement"); Affidavit of Martin J. Sergi ("Sergi Affidavit") & 3. Kelsar granted Peoples a mortgage on the land, known as Harrow Farms Estate ("Harrow Farms"). Exh. 2 to Plaintiff's Statement; Sergi

¹ Neither party challenges its opponent's submissions for failure to conform to Fed. R. Civ. P. 56(e). Rule 56(e) requires that affidavits submitted in support of or in opposition to summary judgment motions "shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit shall be attached thereto or served therewith." A court generally may consider defective affidavits as to which no objection has been made. *See, e.g.*, 10A C. Wright, A. Miller & M. Kane, *Federal Practice and Procedure* 2738 at 507-09 (1983).

Affidavit & 3. Kelsar approached KMS, which it knew from other business dealings, about the possibility of KMS building homes on the Harrow Farms lots. Sergi Affidavit & 3-4. KMS was interested but was unable to secure financing from Peoples to do so. *Id.* & 4. Several months later Kelsar defaulted on the Peoples note. *Id.* & 5. Blaine A. Boudreau, a vice president of Peoples, Affidavit of Blaine A. Boudreau ("Boudreau Affidavit") & 1, suggested that KMS consider assuming the loan and completing the project, which Boudreau promoted "as a high end residential development" with restrictive covenants assuring its quality, Sergi Affidavit & 5-7; Exh. A to Sergi Affidavit. In February 1989 KMS assumed the loan, with modifications, and took over the undeveloped lots on the Harrow Farms property. Sergi Affidavit & 10; Affidavit of Frederick G. Proctor ("Proctor Affidavit") & 3; Exhs. A-1, A-2, A-3 to Proctor Affidavit. KMS built speculative homes on two of the lots, selling one for \$265,000. Sergi Affidavit & 11. KMS failed to make any scheduled monthly payments on the note after February 1990. Proctor Affidavit & 5. In May 1990 Peoples notified KMS of the default; when no payment was forthcoming Peoples initiated foreclosure on the Harrow Farms property. *Id.* & 6-7; Exh. B to Proctor Affidavit. Peoples commissioned an appraisal, which estimated the fair market value of the 14 remaining undeveloped Harrow Farms lots at \$234,000 as of July 18, 1990. Proctor Affidavit & 9; Boudreau Affidavit & 5-6; Exh. 1 to Boudreau Affidavit. At the time of the appraisal, the property was subject to the restrictive covenants and the subdivision's road was unfinished. Proctor Affidavit & 8-9; Boudreau Affidavit & 5. Peoples completed the subdivision road, Proctor Affidavit & 8, and removed the restrictive covenants, Boudreau Affidavit & 3-4. At a public auction held September 8, 1990 the property sold for \$351,000. Proctor Affidavit & 9; Exh. 2 to Plaintiff's Statement. KMS had signed a contract in July 1990 to sell its second Harrow Farms speculative home for \$205,000 to Scott F. and Mary Ann Beliveau. Sergi Affidavit & 14; Exh. B to Sergi Affidavit. When the Beliveaus learned that Peoples had removed the restrictive covenants, they balked and negotiated an amendment under which they

could be released from their contract if the covenants were not reinstated. Sergi Affidavit & 14; Exh. C to Sergi Affidavit. The Beliveaus exercised this right, negotiating a new contract for \$140,000.² Sergi Affidavit & 14; Exhs. D, E to Sergi Affidavit.

The parties sharply dispute the effect of the removal of the restrictive covenants on the property's value and the reasonableness of the decision to remove them. Boudreau avers that the property sold for well over the fair market value it had with the restrictions in place, Boudreau Affidavit & 5; Sergi contends that the Beliveau negotiations evidence the devaluation of the property incident to the restrictions' removal, Sergi Affidavit && 14-15. Peoples seeks a deficiency judgment of \$227,253 with interest from November 14, 1990 of \$62.67 per day, plus legal expenses. Proctor Affidavit && 13-14.

III. LEGAL ANALYSIS

KMS concedes liability on the note it assumed from Kelsar. *See* Objection to Motion for Summary Judgment. However, KMS asserts that Peoples' removal of the restrictive covenants prior to the foreclosure sale violated duties of good faith, mitigation and disposal of collateral in a commercially reasonable manner. Memorandum of Law in Support of Defendant's Objection to Motion for Summary Judgment ("Defendant's Memorandum") at 4-5. As a result, KMS concludes, Peoples' damages must be reduced to the extent its removal of the covenants diminished the value of the property. *Id.* at 6. Peoples contends that its strict compliance with the letter of the relevant foreclosure statutes, 14 M.R.S.A. ' ' 6203-A to 6203-E, entitles it as a matter of law to the full

² The second contract also included changes in financing requirements and in the seller's construction obligations. Sergi Affidavit & 14. The buyers eventually were released from the second contract after requesting additional improvements to the home. *Id.*

deficiency judgment, Reply Brief of Plaintiff Peoples' Heritage Savings Bank ("Plaintiff's Reply Memorandum") at 2-5, and in any event KMS presents no probative evidence of bad faith, *id.* at 5-7.

As an initial matter, KMS wrongly asserts that the duty to dispose of collateral in a commercially reasonable manner, codified in the Uniform Commercial Code ("UCC") at 11 M.R.S.A. ' 9-504, applies to real estate foreclosure sales. *See* Defendant's Memorandum at 6-7. Article 9 of the UCC applies only to personal property and fixtures. *See* 11 M.R.S.A. ' 9-102. The concept of commercial reasonableness bears on the instant case only to the extent it is encompassed within the common-law duties of mitigation and good faith.

Peoples argues, *inter alia*, that its compliance with the foreclosure statutes obviates the need to determine its reasonableness in removing the restrictive covenants. The parties do not cite, and I cannot find, a published Maine opinion considering the question whether the applicable foreclosure statutes were intended to displace common-law defenses. Legislative history dating from the statutes' enactment, while silent on the precise question, places the foreclosure scheme in helpful focus. Floor debate indicates that the Maine legislature authorized power-of-sale foreclosures because of 1) concern that judicially supervised foreclosures were too cumbersome and time-consuming, possibly devaluing commercial properties, Legis. Rec. 3471 (1967), 2) a philosophical belief in the sanctity of parties' freedom to contract, *id.* at 3393-94, 3469-70, and 3) a feeling that corporations generally possessed sufficient sophistication to deal with lenders, *id.* at 3393. The Maine legislature intended to free foreclosure proceedings -- as applied to corporate borrowers -- from the shackles of intensive state supervision. The legislature conceivably could have intended the procedural safeguards enacted into 14 M.R.S.A. ' ' 6203-A to 6203-E to constitute the entire universe of corporate-borrower protection in mortgage foreclosures.³ However, I hesitate to infer such an abrogation of common-law protections in

³ Presumably, the legislature would do so to ensure certainty and speed, and reduce costs, in mortgage foreclosures.

the absence of explicit direction. More likely, the legislature intended to equalize business dealings involving mortgages with other business transactions, which must be conducted within the bounds of contract law. Such a result harmonizes with judicial findings in Maine's sister state of Massachusetts. *See, e.g., Dundas Corp. v. Chemical Bank*, 511 N.E.2d 520, 524 (Mass. 1987); *American Mechanical Corp. v. Union Mach. Co. of Lynn*, 485 N.E.2d 680, 684 (Mass. App. 1985). Peoples' compliance with the statutes hence does not preclude scrutiny of the question whether it breached the common-law duties of good faith and mitigation of damages.'

Maine law implies a covenant of good faith and fair dealing in every contract. *See, e.g., Reid v. Key Bank of S. Maine, Inc.*, 821 F.2d 9, 12-13 (1st Cir. 1987); *Ricci v. Key Bancshares of Maine, Inc.*, 662 F. Supp. 1132, 1141 (D. Me. 1987). The party claiming breach bears the burden of proving it. *See, e.g., Chiapetta v. Lumbermens Mut. Ins. Co.*, 583 A.2d 198, 202 (Me. 1990) (citation omitted). The term "good faith" may be defined subjectively, to mean honest behavior, or objectively, to mean behavior that is reasonable by standards of the business involved. *See, e.g., Reid*, 821 F.2d at 14-15. I am unaware of any published Maine decision defining "good faith" in the context of a real estate foreclosure. However, I believe the term in the instant case should be construed to encompass both subjective and objective elements. The Maine Supreme Judicial Court has suggested that an actor breaches the covenant of good faith by acting "in bad faith or unfairly." *Chiapetta*, 583 A.2d at 202 (citation omitted). Bad faith is measured subjectively; unfairness objectively. *See* Restatement

⁴ Cases cited by Peoples do not compel a different result. In *United States v. Hanson*, 649 F. Supp. 100 (D. Me. 1985), this court refused to construe 14 M.R.S.A. ' 6203-E as extending the right of notice to guarantors. In *Winter v. Casco Bank & Trust Co.*, 396 A.2d 1020 (Me. 1979), the Maine Supreme Judicial Court held that statutory foreclosure requirements must be strictly observed. Neither court determined whether the foreclosure statutes displace or subsume common-law defenses.

(Second) of Contracts ' 205 comment e (1981) ("The obligation is violated by dishonest conduct such as conjuring up a pretended dispute, asserting an interpretation contrary to one's own understanding, or falsification of facts. It also extends to dealing which is candid but unfair, such as taking advantage of the necessitous circumstances of the other party to extort a modification of a contract for the sale of goods without legitimate commercial reason.") *See also Seppala & Aho Constr. Co. v. Petersen*, 367 N.E.2d 613, 620 (Mass. 1977) (applying both subjective, objective tests in measuring good faith in real estate foreclosure). Application of an objective standard to real estate foreclosures also parallels the standard applied to the sale of personalty and fixture collateral under the UCC. *See* 11 M.R.S.A. ' ' 9-504(3), 9-507(2).

Mere inadequacy of price is not probative evidence of breach of the covenant of good faith and fair dealing. *See, e.g., Seppala*, 367 N.E.2d at 620. However, viewing the record in the light most favorable to KMS, one could conclude that Peoples breached the covenant of good faith by either subjective or objective standards. One could infer that (1) removal of the covenants devalued the property and (2) Peoples either acted in bad faith, in view of Boudreau's emphasis on the restrictive covenants when "selling" the loan to KMS, or Peoples acted unreasonably in view of standards for real estate foreclosures in Portland, Maine at that time. Trial is necessary to determine whether the removal of the restrictive covenants did in fact devalue the properties and, if so, whether the removal was undertaken in good faith and was reasonable under the circumstances.

For the same reasons, summary judgment is inappropriate on the issue of failure to mitigate damages. Mitigation is measured by an objective test -- whether the nonbreacher could have avoided loss by reasonable effort. *See, e.g., Lindsey v. Mitchell*, 544 A.2d 1298, 1301 (Me. 1988); *Schiavi Mobile Homes, Inc. v. Gironda*, 463 A.2d 722, 724-25 (Me. 1983); Restatement (Second) of Contracts ' 350 (1981). The defendant bears the burden of proving the feasibility of mitigation. *See, e.g., Lindsey*, 544 A.2d at 1301. Viewing the record in the light most favorable to KMS, one could

conclude that removal of the covenants devalued the property and that Peoples could have retained the covenants without undue risk or burden. Trial is necessary to determine whether this is so.

IV. CONCLUSION

For the foregoing reasons, I recommend that Peoples' motion for summary judgment be GRANTED as to liability and DENIED as to damages.

NOTICE

A party may file objections to those specified portions of a magistrate judge's report or proposed findings or recommended decisions entered pursuant to 28 U.S.C. ' 636(b)(1)(B) for which de novo review by the district court is sought, together with a supporting memorandum, within ten (10) days after being served with a copy thereof. A responsive memorandum shall be filed within ten (10) days after the filing of the objection.

Failure to file a timely objection shall constitute a waiver of the right to de novo review by the district court and to appeal the district court's order.

Dated at Portland, Maine this 8th day of May, 1991.

*David M. Cohen
United States Magistrate Judge*